

**CITY OF SEATTLE**

**PROPOSAL FOR SECTION 108 LOANS**

**TO FINANCE ACQUISITION OF THE ALPS HOTEL AND  
HONG KONG BUILDING IN THE INTERNATIONAL  
DISTRICT**

**UNDER THE CITY'S \$10 MILLION SECTION 108 LOAN FUND**

**JANUARY 25, 2006**

## ALPS HOTEL AND HONG KONG BUILDING

### I. LOAN SUMMARY

**Borrower:** 621 King LLC, a Washington limited liability company  
507 Maynard LLC, a Washington limited liability company  
(collectively, the “LLCs” or the “Borrower”)

**Purpose:** Acquisition financing for the Alps Hotel and Hong Kong Building in the International District.

**Loan Amount:** \$2,260,000 for the Alps Hotel  
\$1,094,000 for the Hong Kong Building

**Term:** 10 years

**Interest Rate:** Section 108 fixed rate of approximately 5.5% (HUD will determine the fixed rate in the annual public offering to be held in the 3<sup>rd</sup> quarter of 2006).

To lower the interest costs, BEDI grant funds in the amount of \$194,007 will be used to pay interest costs in the initial two years of the loan term. Lower interest costs will result in an effective interest rate of approximately 4.86%.

**Principal Repayment:**

Principal payments for the Alps and Hong Kong will be amortized over the 10-year loan term in the following amounts:

2007	95,000
2008	100,000
2009	106,000
2010	112,000
2011	118,000
2012	125,000
2013	132,000
2014	139,000
2015	147,000
2016	155,000
2017	<u>2,125,000</u>
Total	3,354,000

**Security:** 1) Deeds of trust for Alps Hotel and Hong Kong Building  
2) Guaranty of the Koh Family Trust  
3) Brownfields Economic Development Initiative grant funds as additional loan loss reserve, in the cumulative amount of \$370,550.

The loan amount has been limited so that it is projected that the loan amount shall not exceed 80 percent of the value of the two parcels. The projected collateral value is based on current appraisals.

**Loan Fee:** \$33,540 (or 1% of the cumulative \$3,354,000 principal amount due at closing).

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**Administrative/  
Monitoring Fee:**

\$4,000 (annual)

**Financial Reports:** Borrower shall provide the City of Seattle, Office of Economic Development with annual financial statements of the Borrower within 120 days of the end of its fiscal year and a rent roll and annual operating statement for the projects certified by the Borrower.

**Environmental:** All required environmental contaminant removal, remediation and disposal shall be undertaken in full compliance with applicable OSHA standards.

**Approvals:** Disbursement of the loan is conditioned on (i) transfer of property ownership pursuant to executed purchase and sale agreement; (ii) completion of rehabilitation of the subject property, as evidenced by a certificate of occupancy and (iii) lease-up of the subject property sufficient to provide 1.2 debt coverage.

## II. PROJECT DESCRIPTION

The purpose of this Section 108 proposal is to assist with economic and community development activities in the International District neighborhood of Seattle. The proceeds will be drawn from proceeds of a \$10,000,000 City non-recourse note issued under a Contract for Loan Guarantee Assistance with HUD ("Section 108 Loan Fund") \*. The Alps Hotel and Hong Kong Building will be the initial two projects under the Section 108 Loan Fund. 621 King LLC and 507 Maynard LLC will borrow the loan proceeds to acquire the two properties. The BEDI funds in the amount of \$670,800 will be used for payment of loan loss reserve, certain project costs and interest subsidy (as more particularly described in Section IV below).

The Alps Hotel is an historic building located at 621 S. King St. in the International District, and it is physically connected to the adjoining Hong Kong building. The owner James Koh will rehabilitate the Alps Hotel into 117 studio units of rental housing, and 6,000 square feet of ground floor commercial.

The Hong Kong is an historic building located at 507 Maynard Ave S in the International District neighborhood. The owner James Koh will rehabilitate the vacant building into 28,000 square feet of office and retail space and 6 units of rental housing. The Hong Kong will share common areas, elevators and parking facilities with the Alps Hotel.

As described in greater detail in Section IV below, the Koh family will develop the Alps Hotel and Hong Kong through a combination of personal equity and deferred developer fee. The Koh family will claim federal historic tax credits to help offset the costs of rehabilitation. Following completion of rehabilitation, the Koh family will sell ownership of the Alps Hotel and Hong Kong and Alps to separate legal entities known as 621 King LLC and 507 Maynard LLC, respectively. The Koh family will be members of the LLCs. The LLCs will use Section 108

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HUD recently approved the City's \$10 million Section 108 loan application. OED would like to present both the \$10 million Section 108 loan pool and this loan proposal for City Council approval in the 2nd Quarter of 2006.

funds to finance acquisition costs (and related closing costs) for the two buildings.

### III. PUBLIC BENEFIT

#### **CDBG National Objective**

Each project funded under the City's \$10 million Section 108 Loan Fund must meet one of three CDBG national objectives pursuant to 24 CFR 570.200(a)(2) and 570.208:

1. Benefit to low and moderate income families.
2. Aid in the prevention or elimination of slums or blight.
3. Activities meeting community development needs having a particular urgency because existing conditions pose a serious and immediate threat to health or welfare of the community and where other financial resources are not available to meet such needs.

As discussed above, the Alps Hotel and Hong Kong are physically connected in adjoining buildings and will share common areas, elevators and parking facilities. Accordingly, the City will treat the two properties as one project for purposes of meeting CDBG compliance.

The combined Alps Hotel and Hong Kong will meet the national objective of benefiting low and moderate income families through the creation of affordable housing. Pursuant to Section 570.208(a)(3) of the CDBG regulations, at least 51% of the residential units of the project must be occupied by low- and moderate-income households. The combined Alps Hotel and Hong Kong will exceed this minimum standard:

- **Overall affordability requirements:** at least 51% of the residential units of the Alps Hotel and Hong Kong shall have rents affordable to households earning below 70% median income, for a ten year period following rehabilitation.
- **Existing tenants:** rents for existing tenants (80 of the 117 Alps' residential units) shall be subject to the following additional affordability requirements:
  - For an initial two-year period following rehabilitation, existing tenants will pay rents affordable to households earning below 30% median income.
  - For the third through fifth years of the loan, rents for existing tenants may rise no higher than 40% median income.
  - For the sixth through tenth years of the loan, rents for existing tenants may rise no higher than 50% median income.

Also, the combined Alps Hotel and Hong Kong will meet the national objective of benefiting low and moderate income families through the creation of jobs. To qualify as a job creation or retention activity, 24 CFR 570.208(a)(4) requires that the project "create or retain permanent jobs where at least 51 percent of the jobs, computed on a full time equivalent basis, involve the

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employment of low-and moderate-income persons." Section 570.208(a)(4)(iv) and (v) state that if the assisted business is located in a census tract or block numbering area with a poverty rate of at least 20 percent, and if the job is located within that census tract/block group, then the person may be presumed to be a low- or moderate-income person. Because the Alps Hotel and Hong Kong are located in a census block group having a poverty rate of at least 20%, all jobs created will be presumed to benefit low- and moderate-income individuals. The Alps and Hong Kong will create a minimum of 35 new, permanent full-time jobs.

### **108 Eligible Activity**

In addition to meeting a national objective, projects funded under the Section 108 loan fund must meet an eligible activity. The Alps Hotel and Hong Kong will be eligible under 24 CFR 570.703(a) (acquisition of property).

### **Other Public Benefits**

In addition to CDBG compliance, the projects will rehabilitate historic buildings in the International District – a priority goal of the Mayor's Office.

## **IV. DEVELOPMENT BUDGET - PROJECT FINANCING**

The following represents a summary of the development costs, construction financing sources and permanent financing sources. A more detailed development budget is attached as an exhibit to this Loan Proposal.

<b><u>Total Development Costs:</u></b>			
<b>Alps Hotel</b>		<b>Hong Kong</b>	
Acquisition:	\$2,260,000	Acquisition:	\$1,094,000
Site Improvements:	160,000	Site Improvements:	340,000
Construction:	2,868,106	Construction:	3,369,718
Professional Fees:	448,373	Professional Fees:	558,472
Finance Costs:	134,487	Finance Costs:	81,457
Development Costs:	38,000	Development Costs:	45,000
Reserves:	<u>10,000</u>	Reserves:	<u>10,000</u>
Total:	\$5,918,966	Total:	\$5,498,647
<b>Combined Total:</b>	<b>\$11,417,613</b>		

<b><u>Construction Financing Sources:</u></b>	
(For the combined Alps Hotel and Hong Kong)	
Deferred Developer Fee:	741,845
Owner Equity*:	<u>10,675,768</u>

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<b>Total:</b>	<b>\$11,417,613</b>
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\*The owner will claim federal rehabilitation tax credits in the amount of \$1,438,934 to help offset the costs of rehabilitation.

<p style="text-align: center;"><b><u>Permanent Financing Sources:</u></b> (For the combined Alps Hotel and Hong Kong)</p>
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Section 108 Loan:	\$3,354,000
Deferred Developer Fee:	741,845
Owner Equity:	<u>7,321,768</u>
<b>Total:</b>	<b>\$11,417,613</b>

### Section 108 Funds

Borrower will use \$3,354,000 in Section 108 funds to finance acquisition costs (and related closing costs) of the Alps Hotel and Hong Kong. The loan will have a term of 10 years, with the Borrower making monthly principal and interest payments.

Interest for the 108 loan will accrue at the HUD fixed rate of approximately 5.5% (HUD will determine the fixed rate in the annual public offering to be held in the 3<sup>rd</sup> quarter of 2006).

### BEDI Funds

BEDI grant funds in the amount of \$670,800 will be used to cover loan loss reserve (\$370,550), certain project costs (\$106,243) and interest subsidy (\$194,007):

Loan loss reserve: the amount of BEDI reserved for loan loss has been determined according to a HUD approved formula of:

2.5% of the loan	83,850
+ 6 months of debt service	138,430
+ <u>6 months of operating expenses</u>	<u>148,270</u>
= Total Loan Loss Reserve	= 370,550

Project Costs: BEDI grant funds in the amount of \$106,243 will be used to cover City and HUD 108 fees and excise taxes.

Interest Subsidy: to lower interest costs of the Section 108 loan, the remaining BEDI grant funds in the amount of \$194,007 will be used to pay interest costs in the initial year of the loan term. Lower interest costs will result in an effective interest rate of approximately 4.86%.

## V. OPERATING BUDGET – ABILITY TO REPAY

### Primary Source of Repayment

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The primary source of repayment for the loan will be revenue generated by project rental income. The operating pro forma, attached as an Exhibit to this loan proposal, shows the combined rental income of the Alps Hotel and Hong Kong sufficient to achieve a 2.92 debt coverage ratio projected for the first full year of occupancy, with debt coverage in subsequent years well above our underwriting requirement of 1.2. Project revenue will be low due to low rents; however, the debt coverage exceeds our 1.2 standard because the projects will carry a low amount of debt.

Borrower does not currently have preleasing sufficient to meet the 1.2 debt coverage requirement. However, the City will condition disbursement of the loan when the rehabilitation has been completed and the combined project achieves 1.2 debt coverage. If the Borrower requests disbursement prior to achieving 1.2 debt coverage, the Borrower will establish a cash security account (on terms acceptable to the City) in the amount needed to achieve 1.2 debt coverage. These disbursement conditions will protect the City against unexpected delay in lease-up. With respect to the Alps Hotel, full lease-up is expected to occur in a short period of time. Rehabilitation will not displace current tenants in the building, and the building will be nearly 80% occupied upon completion of rehabilitation. The improved condition of the building and the low \$400/month rent will make lease-up attractive for the remaining unoccupied units. Also, the appraisal confirms that the pro forma \$400/month rent is reasonable due to the small size of the Alps' units (144 square feet) compared to larger studios in neighboring buildings. [Appraisal, page 78]. With respect to the Hong Kong, the market analysis in the appraisal confirms that any lease-up delay would be unexpected. Projected rental rates for the Hong Kong office and ground floor commercial space will be \$8.40/sf/year, which is more favorable than the \$16 to 18/sf for comparable space. [Appraisal, pages 111-12]. Also, rental rates for the six residential units range from \$725/month for 1 bedrooms to \$ 925/month for 2 bedrooms. As the appraisal states, these rents will place the units in greater demand than comparable properties with higher rents in the range of \$1,000 (for one bedroom units) and \$1,350 (for two bedroom units). [Appraisal, page 79].

The Alps Hotel and Hong Kong pro formas include a 5 percent vacancy rate. The appraisal confirms that improving market conditions makes 5% a reasonable assumption. [Appraisal, page 112].

The Borrower has made a commitment to maintain the buildings in good condition. The pro forma includes an annual budgeted amount of \$70,236 for repairs and maintenance. This matches the amount listed in the appraisal for comparable properties. The pro forma also indicates replacement reserves of \$300/residential unit/year and \$0.50/sf/year for commercial space, both of which exceed the amounts contained in the appraisal for comparable properties. [Appraisal, pages 85, 115-16].

### **Secondary Source of Repayment**

The secondary source of repayment is recourse to the project collateral as discussed in the section below entitled Collateral.

### **Tertiary Source of Repayment**

The tertiary source of repayment is the financial strength of the Koh Family Trust, known as ABCD Trust ("Trust").

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Analysis of the Trust's financial strength is relevant to determine its ability to provide a guaranty for the loan. OED has reviewed the 2005 financial statement of the Trust as well as federal income tax returns of the Trust from 2002, 2003 and 2004. The bulk of the Trust's assets come from the Koh family's real estate holdings, with only a small portion of such real property secured by mortgages. Moreover, the financials reveal that the Trust has unencumbered assets greatly exceeding the amount of the proposed Section 108 loan. As such, OED has determined that the Trust has sufficient assets to provide an unconditional guaranty for a \$3,354,000 Section 108 loan.

### VI. COLLATERAL

Each 108 loan will be secured by deeds of trust on the subject property. Appraisals on the Alps and Hong Kong confirm that the loan is less than 80% of the combined value of the Alps Hotel and Hong Kong. At the time of loan closing, there will be no other debt except for the Koh's subordinate loan to repay the developer fee.

The following represents the loan to value ratio for the two projects:

$$\begin{aligned}\text{Loan to Value Ratio} &= \frac{\text{Loan Amount}}{\text{Fair Market Value of Collateral}} \\ \text{Loan Amount for Alps Hotel} &= \$2,260,000 \\ \text{Loan Amount for Hong Kong} &= \$1,094,000 \\ \text{Fair Market Value of Collateral [Appraisal, pages 4-5]} &= \\ \$6,440,000 \text{ for Alps Hotel} & \\ \$5,140,000 \text{ for Hong Kong} & \\ \text{Combined Loan to Value} &= \frac{\text{Loan Amount } (2,260,000+1,094,000)}{\text{Fair Market Value of Collateral } (6,440,000+5,140,000)} \\ \text{for both projects} &= \\ \text{Loan to Value Ratio} &= .29\end{aligned}$$

Individually, each project falls well below the 80% loan to value maximum:

$$\begin{aligned}\text{Loan to Value Ratio} &= \frac{\text{Loan Amount } (\$2,260,000)}{\text{Fair Market Value of Collateral } (\$6,440,000)} \\ \text{for Alps Hotel} &= \\ \text{Loan to Value Ratio} &= .35 \\ \text{Loan to Value Ratio} &= \frac{\text{Loan Amount } (\$1,094,000)}{\text{Fair Market Value of Collateral } (\$5,140,000)} \\ \text{for Hong Kong} &= \\ \text{Loan to Value Ratio} &= .21\end{aligned}$$

In addition, the City will have the unconditional guaranty from the Koh Family Trust.



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Due to the high amount of equity contributed by the Koh family (in excess of \$7 million), OED anticipates that Borrower will desire to replace a portion of such equity with private financing. If Borrower obtains private financing prior to the end of the 10-year 108 loan term, the City will agree to subordinate the Section 108 loan to private financing, so long as: (i) the loan to value ratio for private financing and the Section 108 loan does not exceed 70% and (ii) the combined revenue of the Alps and Hong Kong achieves a minimum 1.3 debt coverage.

### **VII. DEVELOPMENT TEAM AND EXPERIENCE**

The Koh family will serve as project developer, general contractor and property manager of the Alps Hotel and Hong Kong. The Koh family has considerable experience in developing and managing housing and mixed use projects. This includes several apartment buildings in the University District and Belltown, as well as residential projects in Bellevue, Everett and Blaine, Washington. A complete list of the Koh family's projects and resumes are attached as an exhibit to this loan proposal. These projects have involved new construction and rehabilitation of existing projects.

The Koh family has engaged the services of Tonkin/Hoyne/Lokan as architect for the project. Principal Les Tonkin has over 30 years of experience in the Northwest, working on a wide range of new construction and rehabilitation projects. Projects have included the Seattle Housing Authority's Rainier Vista redevelopment; the Bush Hotel renovation in International District; and the Frye Hotel rehabilitation in Pioneer Square. A list of Tonkin/Hoyne/Lokan's projects and resumes are attached as an exhibit to this loan proposal.

### **VIII. DEVELOPER/OWNER COMMITMENT**

The Koh family has committed over two years in the design and planning for the Alps Hotel and Hong Kong. They will also commit over \$7 million in equity to complete rehabilitation of the two projects. Finally, they have shown a willingness to create public benefits consistent with the Mayor's policy objectives in the International District. The two projects will include historic rehabilitation and preservation of affordable housing over a minimum ten year period. This demonstrates considerable commitment of the Koh family.

### **IX. CHARACTER**

As described above, the applicant (through the actions of the Koh family) has committed a substantial amount of time and resources to the project. Such contribution demonstrates the applicant's dedication to completion of the two projects. The applicant's character can be seen clearly in its actions.

### **X. PROPOSED COSTS**

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The development budget has been thoroughly reviewed and has reasonable cost estimates. The Koh family has completed the design, plans and specifications for the Alps Hotel and Hong Kong, and they have also obtained all permits. Construction cost estimates reflect information from actual bids received from contractors. The Koh family has obtained part two approval from the National Park Service, for federal rehabilitation tax credits.

As described above, the Section 108 loan will not be disbursed prior to the completion of rehabilitation. As a result, the City's loan will not be at risk due to cost overruns or other problems experienced during the construction phase of the projects.

### **XI. COMMITMENT OF FUNDS**

Commitment of the Section 108 loan will complete the financing package for the two projects. As described above, the remaining financing will come from the Koh family.

### **XII. NEED FOR PUBLIC ASSISTANCE**

Due to the high cost of rehabilitation, relatively low rents for residential and commercial space and high amount of owner equity contributed to the two projects, the Koh family will receive a very modest return on the two projects. The combined cash on cash return for the two projects will be approximately 5.92% and the internal rate of return will be approximately 3.03%. Without the low cost Section 108 loan, the two projects would not generate a positive return for the Koh family. As a result, the Section 108 loan is needed to make the projects feasible.

In the event that the City does not approve the Section 108 loan, it is anticipated that the Koh family would reduce its project budget to avoid receiving a negative return. The Koh family would most likely focus its resources on completion of the Alps, which has a stable source of revenue through existing tenants, and avoid completion of the rehabilitation of the Hong Kong, which has no existing source of revenue.